

ESSAY RESPONSE TO ASYMMETRIES IN THE GENERATION AND TRANSMISSION OF WEALTH

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In an excellent recent Article, *Asymmetries in the Generation and Transmission of Wealth*, Professor Felix Chang offers a bold critique of the freedom of disposition,¹ the venerable organizing principle of wealth transfer law in the United States.² With plainspoken eloquence, Chang argues that wealth transfer law should not aim merely to facilitate private donative preferences, but rather, it should also promote social welfare in ways that reduce economic inequality and stimulate wealth redistribution.³ Chang supports this claim by identifying a previously overlooked asymmetry between the under-regulation of wealth transmission and the more robustly progressive economic regulation of wealth generation.⁴ Mustering sophisticated command of social welfare and law-and-economics theory, Chang offers several innovative reform proposals to slow the trend of increasing wealth inequality by redistributing capital across the vast majority of individuals who live outside the elite top percentile of asset ownership.

Chang begins with a normative assertion that public policy should constrain wealth inequality because high concentrations of capital ownership inhibit economic growth; this inhibition, in turn, causes wage stagnation, unemployment, and depressed productivity, among other social harms.⁵ Chang observes that the extant state of economic disparity arises, at least in part, from wealthy elites exerting political power over lawmakers to favor policies that exacerbate and entrench the problem of wealth inequality.⁶ At the same time, the social service expenditures most beneficial to the poor and middle classes, such as public health and education programs, have waned from chronic underfunding.⁷ Many scholars have therefore come to view wealth inequality as a social problem that perpetuates institutionalized disadvantages for the poor and facilitates anti-democratic political influence by a small class of affluent elites.⁸

The social welfare harms and anti-democratic side-effects of wealth inequality are most pronounced when the distribution of economic resources

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¹ Felix Chang, *Asymmetries in the Generation and Transmission of Wealth*, 79 OHIO ST. L.J. 73 (2018).

² RESTATEMENT (THIRD) OF PROPERTY (WILLS & DON. TRANS.) § 10.1, cmt. a (2003) (“The organizing principle of the American law of donative transfers is freedom of disposition. Property owners have the nearly unrestricted right to dispose of their property as they please.”).

³ Chang, *supra* note 1, at 78.

⁴ *Id.*

⁵ *Id.* at 86–88.

⁶ *Id.* at 89 & n.85.

⁷ *Id.* at 88–89.

⁸ See James R. Repetti, *Democracy, Taxes, and Wealth*, 76 N.Y.U. L. REV. 825, 827 (2001).

across society becomes highly disproportionate.⁹ The threshold question, therefore, is one of degree: How much economic disparity is enough to manifest a measurable adverse impact on social welfare? A growing empirical literature in the field of economics has sought to quantify and measure the extent of wealth inequality,¹⁰ but reasonable minds may differ about how much capital accumulation by the richest elite is tolerable by society before reaching a level of economic disparity that requires regulatory intervention. Most Americans would probably agree that a capitalist free-market political system must tolerate at least some level of wealth inequality, but how much?

At one end of the spectrum, libertarians might argue that society should be highly tolerant of economic inequality because ability, talent, and willingness to devote time and labor to economic activity vary significantly from one person to the next, so the reward outputs from labor, effort, skill, and productivity should be expected to vary as well. A policy of mandating economic equality, therefore, would not only untenably infringe upon liberal principles of individual autonomy and private property, but would also severely depress incentives to engage in activities that require innovation and assumption of economic risk. Proponents of this view would cite the communist political systems that amassed great power in the twentieth century, but that subsequently collapsed (Soviet Union)¹¹ or largely abandoned their most extreme redistributive policies (China).¹² At the other extreme end of the resource distribution spectrum, progressive advocates of economic equality might argue that an entirely free-market system leaving wealth inequality completely unchecked not only harms the poor and middle classes, but it can destabilize the foundations of civil order, as King Louis XVI of France¹³ and Czar Nicholas II of Russia¹⁴ discovered the hard way at the hands of an angry, impoverished populace.

While economic distribution preferences are highly variable and difficult to measure, recent studies have shown that Americans tend to prefer a more equal distribution of capital across society.¹⁵ And yet, other studies show that

⁹ See *id.*

¹⁰ See THOMAS PIKETTY, *CAPITAL IN THE TWENTY-FIRST CENTURY* (2017).

¹¹ See Beta B. Rybczynski, *The Ideological Collapse of Soviet-Style Regimes in the Eyes of Western Theorists*, 24 POLISH POL. SCI. Y.B. 163 (1994).

¹² See Xiangming Chen & Xiaoyuan Gao, *China's Urban Housing Development in the Shift from Redistribution to Decentralization*, 40 SOC. PROBS. 266 (1993).

¹³ See Elizabeth Bond, *The Execution of Louis XVI*, ORIGINS (Jan. 2018), <http://origins.osu.edu/milestones/january-2018-execution-louis-xvi> [<https://perma.cc/87PQ-MTCU>].

¹⁴ See Erin Blakemore, *Why Tsar Nicholas II and the Romanovs Were Murdered*, HISTORY (Oct. 25, 2018), <https://www.history.com/news/romanov-family-murder-execution-reasons> [<https://perma.cc/YN6F-7SQ3>].

¹⁵ See Michael I. Norton & Dan Ariely, *Building a Better America—One Wealth Quintile at a Time*, 6 PERSP. ON PSYCHOL. SCI. 9, 10 (2011) (describing how 90% of survey respondents preferred wealth distribution with equal or roughly equal allocations among all five quintiles).

Americans tend to underestimate the true extent of wealth inequality.¹⁶ Among the wealthy (and soon-to-be wealthy) elite, however, distributional preferences tend to skew toward greater tolerance of wealth inequality. Consider, for example, a fascinating recent study of distributional preferences among Yale Law School students, who, by virtue of their educational pedigree, are likely to join the ranks of the influential political and economic elite.¹⁷ Almost all study participants in the Yale Law School student cohort identified as members of the Democratic Party, an affiliation that would seem to imply agreement with progressive ideas about economic equality.¹⁸ But when compared to study participants regarded as less elite, the Yale student cohort exhibited a significantly higher preference for efficiency over equality and conducted themselves in a manner described by researchers as more “selfish” than “fair-minded” than the control group cohorts.¹⁹ Thus, even the most progressively minded elite may unconsciously behave in ways that promote rather than curtail wealth inequality.

Economic inequality in the United States is not extreme enough to presage a political revolution, but the current level of wealth concentration is astonishingly high. By one measure, for example, the richest 20% of Americans now own more than 95% of all capital wealth in the United States.²⁰ In another study, renowned French economist Thomas Piketty estimated that, as of 2010, the richest 1% of Americans owned nearly 35% of all capital assets in the United States.²¹ Chang, therefore, laments the downfall of political support for federal transfer taxes, which once served as the government’s primary tool for curbing wealth concentration.²² The gift, estate, and generation-skipping transfer taxes impose excise taxes on the privilege of transferring wealth, but opponents of federal transfer taxes have long argued that this produces double taxation after payment of income taxes and disrupt family businesses by requiring liquidation of business assets to satisfy large tax obligations.²³ Such criticisms are largely overblown, as Congress has

¹⁶ See, e.g., Ilyana Kuziemko et al., *How Elastic Are Preferences for Redistribution? Evidence from Randomized Survey Experiments*, 105 AM. ECON. REV. 1478, 1487 (2015); see also Norton & Ariely, *supra* note 15 (describing a survey where respondents “vastly underestimated the actual level of wealth inequality in the United States, believing that the wealthiest quintile held about 60% of the wealth when the actual number is closer to 84%).

¹⁷ Raymond Fisman et al., *The Distributional Preferences of an Elite*, 349 SCIENCE aab0096, aab0096-4 (2015).

¹⁸ *Id.*

¹⁹ *Id.*

²⁰ See, e.g., Paul L. Caron & James R. Repetti, *Occupy the Tax Code: Using the Estate Tax to Reduce Inequality and Spur Economic Growth*, 40 PEPP. L. REV. 1255, 1260 (2013) (“From 1983 to 2010, the share of wealth [excluding personal residence] of the top 20% rose from 91.3% to 95.3% . . .”).

²¹ PIKETTY, *supra* note 10, at 440.

²² Chang, *supra* note 1, at 85–86.

²³ Michael J. Graetz, “Death Tax” *Politics*, 57 B.C. L. REV. 801, 805–08 (2016) (noting that the imposition of the estate tax adversely impacts family farms and, at least in some cases, imposes a tax on assets that were also subject to income tax at the time of acquisition).

enacted solutions, such as a fourteen-year payment deferral for closely held businesses,²⁴ to prevent family farms and businesses from having to liquidate assets to pay federal transfer taxes. And indeed, in recent decades, Congress significantly scaled back the wealth transfer taxes by reducing the tax rate from 77% to 35%, since increased to 40%, and significantly increasing the exemption amount from \$40,000 to more than \$5 million.²⁵ In 2017, President Donald Trump proposed eliminating the estate and generation-skipping transfer taxes altogether.²⁶ Congress did not fully embrace the White House repeal proposal, but it did temporarily double the transfer tax exemption amount to \$11.2 million for individuals and \$22.4 million for married couples, as of 2018.²⁷

Because Chang believes (as do I) that recent efforts to scale back federal transfer taxes will eventually become permanent,²⁸ he suggests that law reformers should focus on the non-tax rules of wealth transfer law to pursue wealth redistribution and promote social welfare.²⁹ And yet, so many aspects of wealth transfer law are inextricably intertwined with transfer tax law that it becomes difficult to exclude consideration of transfer taxes from social welfare policy reform.

Take, for example, the Rule Against Perpetuities, which Chang argues should be strengthened and reinstated so as to constrain the inter-generational accumulation of wealth.³⁰ While the Rule Against Perpetuities is, itself, a non-tax rule of wealth transfer law, two of Chang's reform proposals reflect the long shadow cast by the transfer tax system on the state property laws governing perpetuities. One of Chang's proposals suggests that states directly tax dynasty trusts, which would effectively impose a transfer tax at the state rather than federal level.³¹ But if transfer taxes have proven politically untenable under federal law, it seems unlikely that state legislatures would choose to impose a similar tax at the state level. Another of Chang's proposals suggests that states should reinstate the common law Rule Against Perpetuities "to abolish the inter-state race to the bottom."³² The race to which Chang refers is the trend among state jurisdictions to authorize dynasty trusts that

²⁴ See 26 U.S.C. § 6166 (2018).

²⁵ See generally William G. Gale & Joel B. Slemrod, *Rethinking the Estate and Gift Tax: Overview* (Nat'l Bureau of Econ. Research, Working Paper No. 8205, 2001), <https://www.nber.org/papers/w8205> [<https://perma.cc/WN84-KYZZ>] (providing an empirical analysis of the shift in wealth transfer taxes).

²⁶ THE WHITE HOUSE, UNIFIED FRAMEWORK FOR FIXING OUR BROKEN TAX CODE 6 (2017), <https://www.treasury.gov/press-center/press-releases/Documents/Tax-Framework.pdf> [<https://perma.cc/3XG9-DW8L>].

²⁷ 26 U.S.C. § 2010(c)(3)(C) (2018) (increasing the basic exclusion amount to ten million, as indexed for inflation beginning in 2011).

²⁸ Note, however, that the recent increase in the transfer tax exemption amount sunsets on December 31, 2025. *Id.*

²⁹ Chang, *supra* note 1, at 82.

³⁰ *Id.* at 94–95.

³¹ *Id.* at 97.

³² *Id.* at 25.

exploit a wide loophole for perpetual trusts under the federal Generation-Skipping Transfer Tax.³³ Yet, if federal transfer taxes are eventually repealed entirely and permanently, then the race to authorize dynasty trusts would no longer serve its intended purpose of providing perpetual exemption from the GST tax because all transfers would pass tax-free whether or not conveyed in trust. Chang acknowledges that “the efficacy of [reinstating the Rule Against Perpetuities] depends as much on the robustness of estate taxes as on the perpetuities period; where tax exemptions are large and tax rates slim, the redistributive effects of the RAP will be hampered.”³⁴ In the field of wealth transfer law, which evolved over time in a symbiotic relationship to transfer tax law, it is difficult to conceive of redistributive reforms that are wholly divorced from tax law.

Thus, I agree with Chang both in that “the tax system is the most efficient way to address inequality,”³⁵ and that federal transfer taxes as presently configured are (at best) on the decline and (at worst) on the road to outright repeal.³⁶ And yet, I am decidedly more optimistic about the potential for new configurations of death-time government claims to serve a more robust and meaningful role in promoting social welfare. With a bit of legislative creativity, lawmakers may find other ways to repurpose the well-tested statutory and regulatory transfer tax framework to achieve the redistributive goals of greater wealth equality without actually imposing a wealth transfer tax in its conventional form.

Consider, for example, an application of the transfer tax apparatus in the context of entitlement reform, which may soon require austerity measures to contain the rapidly increasing costs of the Medicare and Social Security retirement benefit programs. To date, Congress has rejected austerity reforms that would disqualify retirees with ample independent financial resources from collecting Medicare and Social Security retirement benefits.³⁷ Under current law, individuals who meet the age and eligibility requirements may participate in the Medicare and Social Security old-age programs without regard to financial need (or lack thereof).³⁸ By contrast, so-called “means testing” proposals would establish income and asset ceilings to limit Medicare and Social Security eligibility only to individuals who could not otherwise afford to retire.³⁹ Financial means testing, however, may prove highly unpopular if

³³ See, e.g., Reid Kress Weisbord, *Trust Term Extension*, 67 FLA. L. REV. 73, 108–09 (2015).

³⁴ Chang, *supra* note 1, at 98.

³⁵ *Id.* at 96.

³⁶ *Id.* at 90–91.

³⁷ See Richard McGahey, *The Political Economy of Austerity in the United States*, 80 SOC. RES. 717 (2013).

³⁸ See *Reforming Social Security Option: Begin Means-Testing Social Security Benefits*, AARP PUB. POL’Y INST. (June 22, 2012), https://www.aarp.org/content/dam/aarp/research/public_policy_institute/econ_sec/2012/option-means-test-social-security-benefits-AARP-ppi-econ-sec.pdf [https://perma.cc/3U3L-47TY].

³⁹ See generally *id.* (providing basic arguments for and against means testing).

imposed on individuals who contributed payroll taxes into the system with the expectation of collecting retirement benefits from both programs upon reaching the statutory definition of old age. Restricting entitlement eligibility may also discourage individuals from saving for retirement so as to avoid hitting the disqualification ceiling.

But what if entitlement eligibility restrictions were imposed at death rather than at retirement? As I propose elsewhere, the political unpopularity of austerity measures could perhaps be appeased by gradually phasing in a system of postmortem, retroactive disqualification for wealthy decedents who leave behind large estates.⁴⁰ For such decedents, lack of financial need for the entitlements paid during life could be objectively and definitively determined at death whenever a decedent's estate exceeds a high dollar amount threshold. Such estates would then be liable for paying back some or all of Social Security and Medicare benefits paid to the decedent during life. A system of postmortem austerity implemented for the purpose of entitlement reform could repackage the concept of federal transfer taxation as a postmortem government claim for disqualified benefits against a decedent's estate rather than as an excise tax on the decedent's transfer of wealth. As further described below, such a program would have to balance the vested interests of current beneficiaries against future needs:

To avoid constitutional challenge and reduce incentives for wasteful end-of-life consumption, postmortem austerity should not entirely deprive disqualified participants of the power to transmit property at death. One way to preserve the freedom of disposition would be to cap the overall recoverable amount of disqualified benefits at 40% of the decedent's estate, thereby leaving the decedent with testamentary power over the remaining 60% of assets owned at death. Further, to implement austerity progressively, the amount of the repayment obligation might be tied to the size of the estate, such that an estate of \$1 million would be liable for 25% of the cost of lifetime benefit outlays while an estate of \$10 million would be initially liable for 100% of that cost. A disqualification ceiling would also help retain the insurance function of Medicare by relieving estates of the full burden of any extraordinary medical costs incurred by the decedent. The repayment obligation should also be offset by Medicare premiums paid by the decedent while receiving medical benefits during life. To avoid disruption within the family unit, the repayment obligation should be deferred until the death of a surviving spouse. And, to facilitate adequate advance planning, implementation of any austerity reform should be phased in with at least fifteen years' notice such that any new eligibility rule would not apply to anyone currently over the age of fifty.⁴¹

A postmortem austerity reform patterned after the federal transfer tax system would: (1) allow all individuals to remain eligible for entitlement benefits during life (and, thus, relieve any fear of old age impoverishment), (2)

⁴⁰ See Reid Kress Weisbord, *Postmortem Austerity and Entitlement Reform*, 71 STAN. L. REV. ONLINE 132 (2018).

⁴¹ *Id.* at 135–36 (footnote omitted).

reduce incentives created by a conventional means testing system to avoid saving for retirement; (3) promote progressive goals of redistribution by confining benefit disqualification rules to estates left behind by wealthy decedents who were demonstrably capable of paying for their own expenses during life; (4) encourage at least some wealthy individuals to voluntarily opt out of Social Security and Medicare during life, thereby conserving scarce public resources for individuals in need of old age financial support; and (5) enable wealthy individuals to plan for the postmortem repayment obligation in a manner that minimizes adverse impact on the decedent's survivors.⁴² Such reforms would seem comfortably aligned with Chang's proposal to promote wealth redistribution through reforms that do not rely on the ever-unpopular federal transfer tax system in its current form.

Professor Chang deserves much praise for opening a new dialogue about the adverse economic and distributive impacts of wealth transfer law. He has laudably encouraged lawmakers to consider innovative reforms to reduce extreme concentrations of capital in the hands of a small class of ultra-rich elites and to reverse the resulting anti-democratic influences produced by wealth inequality. As legislators persuaded by Chang's clarion call begin their search for creative law reform solutions, however, I hope they will not entirely overlook the highly reliable and well-tested regulatory structure of the federal transfer tax system, despite recent decades of successful lobbying efforts eliminate the so-called "death tax." There are, indeed, promising ways in which our century of experience with transfer taxation may be repurposed in other contexts, such as entitlement reform, to achieve the ends of wealth redistribution and greater economic equality.

⁴² *See id.*